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IN THE

Supreme Court of the United States

OCTOBER TERM, 1943.

No. 458

NATIONAL SECURITIES CORPORATION,
SUCCESSOR BY MERGER TO
AMERICAN GAS & ELECTRIC SECURITIES CORPORATION,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT, AND BRIEF IN SUPPORT THEREOF.

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Of Counsel.

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INDEX.

	Page
Petition for Writ of Certiorari	1
A. Summary Statement of Matter Involved	2
B. Jurisdiction	6
C. The Question Presented	6
D. Reason Relied on for the Allowance of the Writ	6
Brief in Support of Petition for Certiorari	9
I. Opinion Below	9
II. Jurisdiction	9
III. Statement of the Case	10
IV. Specification of Error	10
V. Statutes Involved	10
VI. Argument	10
Appendix	18

AUTHORITIES.

1. Cases.

Amerex Holding Co. v. Commissioner, 37 B. T. A. 1169, Aff'd. 117 F. (2d) 1009	13
Hyatt Roller Bearing Co. v. United States, 43 F. (2d) 1008	13
United States v. Chase, 135 U. S. 260, 34 L. ed. 117	16

2. Statutory Provisions.

Revenue Act of 1936 (49 Stat. L. 1648, C. 690)	18
Section—	
23	6, 10, 15
23(f)	10
23(h)	10
45	5, 6, 10, 11, 12, 14, 15, 16
112	6, 10, 15
112(a)	6, 10, 15
112(b)(5)	11, 13
113	6, 10, 15, 16
113(a)(8)	11, 13, 14, 16

Page

113(b) 10, 11
117(d) 4

Revenue Act of 1921:
Section 202(c)(3) 13

Revenue Act of 1924:
Section 204(a)(8) 13

3. MISCELLANEOUS.

Senate Committee Print, 68th Cong. 1st Sess., March 6, 1924 13

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

MAY IT PLEASE THE COURT:

The petition of National Securities Corporation, Successor by Merger to American Gas & Electric Securities Corporation, respectfully shows to this Honorable Court:

A.

SUMMARY STATEMENT OF THE MATTER INVOLVED.

Petitioner seeks review of a decision of the United States Circuit Court of Appeals for the Third Circuit, rendered July 28, 1943 (R. 72-3), affirming the decision of the United States Board of Tax Appeals which sustained in part a deficiency in income taxes asserted by the Commissioner of Internal Revenue for the year 1936.

The material facts are as follows:

American Gas & Electric Securities Corporation (hereinafter called the taxpayer) was incorporated under the laws of the State of Maryland on June 23, 1925. National Securities Corporation (hereinafter called the petitioner) was incorporated under the laws of Maryland on September 24, 1929. On December 27, 1939, in accordance with the Maryland statutes, the taxpayer became merged into the petitioner, and thereupon the separate existence of the taxpayer ceased and the petitioner became primarily liable for all debts, liabilities and obligations of the taxpayer and succeeded to all of its property, rights, privileges and franchises. The petitioner's principal office is at 880 Bergen Avenue, Jersey City, N. J. The return of the taxpayer for the period here involved was filed with the Collector for the Fifth District of New Jersey. (R. 46-47)

Taxpayer, at all times since its organization and until the merger aforesaid, was a wholly owned subsidiary of American Equitable Assurance Company of New York, a fire insurance corporation (hereinafter called the parent). At January 1, 1936, the taxpayer's issued and outstanding capital stock consisted of 3,000 shares without par value. Taxpayer's sole business was that of investing in securities and the purchase and sale thereof. The fair market value of its net assets at December 31, 1935, amounted to approximately $276,270, the parent having paid $300,000 in cash for taxpayer's stock. (R. 47)

At various times between August 8, 1929, and June 7, 1933, the parent purchased as an investment 3500 shares of the common stock of Standard Gas & Electric Company (hereinafter called Standard) at a cost of $418,780.19, of which 1,000 shares were purchased in August and September, 1929, at a cost of $140,378.06. (R. 47)

The stock of Standard was listed on the New York Stock Exchange, and the fair market value thereof on December 19, 1935, was approximately $6.25 per share. (R. 47)

During January, 1936, the parent sold 2500 shares of said Standard stock in the open market at prices ranging from $7.75 to $9.125 per share. (R. 47) These sales resulted from the decision of the Executive and Finance Committee of the parent's Board of Directors that the corporation should reduce its position as an investor in Standard's common stock. This decision was based upon the following considerations:

(a) That Standard, which was a very highly complex utility holding company (R. 32), was then in the midst of a reorganization under Section 77(b) of the Bankruptcy Act. (R. 28)

(b) The parent's Standard holdings represented its largest utility investment, and the investment in which it had the largest depreciation (R. 28-9), and the directors wanted to "clean up the portfolio." (R. 28-30, 33-35)

After these sales were made, the parent's Executive and Finance Committee decided that there was sufficient prospect of a future rise in the market value of the stock to justify retention of the remaining 1,000 shares. (R. 29-30, 35-36) However, they felt that the stock of a company involved in reorganization under the Bankruptcy Act did not look well in the portfolio of an insurance company and, for this reason, it was decided that the parent should transfer it to the taxpayer in return for additional capital stock of the taxpayer. (R. 30)

On February 13, 1936, pursuant to appropriate resolutions by the directors of the parent and the taxpayer, the parent delivered to the taxpayer the remaining 1,000 shares of Standard common stock (which had cost the parent $140,378.06 in 1929, and which were worth $8,562.50 on February 13, 1936) in exchange for 800 shares of the taxpayers authorized no-par capital stock, having a stated value of $10 per share. (R. 48-50)

At the time of this exchange, no decision had been made by the directors of either parent or taxpayer to sell the 1,000 shares of Standard stock, the subject of the exchange. The only decision reached was for the taxpayer to hold it and await market developments, in the hope that the value would increase. (R. 32-33) At that time, it was impossible to forecast the resulting gains or losses from security sales by either corporation in 1936, and no thought was given by the directors to the question of tax results from future sale. (R. 33) At that time, the parent owned 246 different stocks and bonds, representing 600 or 700 separate purchases, and 129 of these separate purchases had increased in value over cost by an amount aggregating more than $757,000. (R. 38-39) During the period from January 1 to February 13, 1936, the parent purchased 110 different lots of securities and sold 97 different lots; between February 13 and December 31, 1936, it bought 569 different lots and sold 637 different lots. The results of the parent's sales for the year 1936 reflected the following:

Profits	$1,706,683.76
Losses	1,723,376.88
Net capital loss	$16,693.12

In its 1936 federal income tax return, the parent claimed and was allowed (in accordance with sections 117(d) and 204(c)(5) of the Revenue Act of 1936) only $2,000 of such capital net loss. (R. 39-41)

Standard published a comparative statement of its income for the period of twelve months ended September 30, 1935, and for a like period ended September 30, 1936, which comparative statement was received and examined by taxpayer's directors about November 15, 1936. This statement (R. 31-32, 51-52) showed a downward trend of earnings and piling up of preferred dividend arrearages, which indicated to the directors that the common stock's position was getting steadily worse. They therefore decided to "get out of the whole Standard picture", and on December 11, 1936, the taxpayer sold, on the market, the 1,000 shares of Standard at market price, receiving therefor the net amount of $7,175. The proceeds of this sale were kept by the taxpayer, and no part thereof has ever been paid to the parent. (R. 31, 52) The determination to sell resulted from a study of the comparative income statement above mentioned (R. 31-32), and the trend of developments occurring after February in connection with the Standard reorganization. (R. 29-33)

In computing its taxable income for the year 1936, taxpayer deducted as a loss on the sale of said 1,000 shares of Standard stock the amount of $133,203.06, being the excess of the cost to the parent over the amount received by taxpayer on the sale. The Commissioner disallowed the loss claimed on the Standard stock and asserted an income tax deficiency of $39,367.00 against taxpayer. (R. 9-10, 52)

The income and expenses of the taxpayer were accurately recorded in separate books of account kept by it and none of its accounts was commingled with those of the parent. (R. 53)

On appeal by petitioner, the Commissioner's counsel conceded that he was in error in disallowing the entire loss, but contended that, under section 45, the taxpayer's loss should be measured by treating as its basis the value of the Standard stock on February 13, 1936, the date it acquired the same from the parent. The Board and the Court below sustained this contention, thus denying the taxpayer the

right to deduct $131,815.56 of the total claimed loss of $133,-203.06.

B.

JURISDICTION.

The jurisdiction of this Court is invoked under the provisions of the Judicial Code, Section 240, as amended by Act of Congress, February 13, 1925, 43 Stat. 938 (U. S. C. A., Tit. 28, Sec. 347).

C.

THE QUESTION PRESENTED.

Does Section 45 of the Revenue Act of 1936 (26 U. S. C. A., Int. Rev. Acts, 1936, p. 840) authorize the Commissioner of Internal Revenue to disallow, in whole or in part, a loss computed in accordance with the provisions of sections 23, 112 and 113 of the same Act, on a determination by him that the disallowance of such loss is necessary "in order clearly to reflect the income"?

D.

REASON RELIED ON FOR THE ALLOWANCE OF THE WRIT.

The Court below has decided an important question of federal law which has not been, but should be, settled by this Court, in that it has held that section 45 of the Revenue Act of 1936 authorizes the Commissioner, in his discretion, to allocate deductions between related corporations in a manner in conflict with specific provisions of the revenue laws, on a finding by him that the application of such specific provisions does not clearly reflect income. This is a question of continuing importance because the section involved has been continued in force in later revenue acts.

WHEREFORE, your petitioner respectfully prays that a writ of certiorari be issued out of and under the seal of

this Honorale Court, directed to the United States Circuit Court of Appeals for the Third Circuit, commanding that court to certify and to send to this Court for its review and determination, on a day certain to be named therein, a full and complete transcript of the record and all proceedings in the case numbered and titled on its docket, No. 8172, National Securities Corporation, Successor by Merger to American Gas & Electric Securities Corporation v. Commissioner of Internal Revenue, Respondent, and that the said judgment may be reversed by this Honorable Court, and that your petitioner may have such other and further relief in the premises as to this Honorable Court may seem meet and just; and your petitioner will ever pray.

NATIONAL SECURITIES CORPORATION,
Successor by Merger to
AMERICAN GAS & ELECTRIC SECURITIES CORPORATION.

By_____
Counsel for Petitioner.